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**Advisory Committee of the Auditing Profession**  
**Mr. Arthur Levitt Jr, Co-Chair**  
**Mr. Donald T Nicolaisen, Co-Chair**  
**US Department of the Treasury**  
**Washington DC 20220**

May 23, 2008

Dear Chairmen Levitt and Nicolaisen,  
Members of the Advisory Committee,

*“Please do throw away the bathwater from time to time,  
there is not **always** a baby in it”.*

Alexander Pola

With reference to the draft report of 05/05/08 of the Committee and the Committee's kind invitation for comment, in preparation for my testimony at the scheduled June 3 2008 Committee's meeting, this letter summarizes my main observations for the welcome occasion. I will conveniently limit myself to the essentials as I see them of the governance and transparency considerations as per the draft report; but go beyond what the Committee may more narrowly consider as its prime remit, i.e. strengthening the audit profession beyond SOx. All this playing out in the context of a most serious credit crunch crises - still thundering along as we speak.

To put my cards on the table up front: I do not see this crises as primarily a collective audit performance failure or only wrongheaded timing of monetary policies, but rather as an intrinsic overly permissive massive regulatory/ rating agency oversight failure. Allowing the financial community to run amok in a the-sky-is-the-limit operating environment. With appearance substituting for reality checks; greed substituting for rhyme and reason; black holes in the financial system figuring as shining stars; deregulation turning religion; no one adding up the unknowns in the systemic equation; no ownership for the blind spots on the oversight radar, hence no leadership and accountability. And a fragmented and disjointed oversight architecture, predicated on

evasive syndicated responsibilities, allowing the blind leading the lame leading the deaf leading the dumb; none being forced to express in results terms the bottom lines of their remits.

In short, a perfect picture scenario to remind us why shoot happens.

This is not to say that the audit profession should be totally left off the hook and could not have played a more robust role in having prevented this all, and/or in preventing the next crises. Reason why I most welcome the thrust of the Committee's recommendations per its draft report.

But I do think the Committees recommendations on one and one only of the micro-gatekeepers, i.e. the audit profession, could gain more muscle by reinforcing also the macro-accountability frameworks of regulators and oversight bodies themselves which, on the one hand *rule*, but on the other hand also *serve* the auditing profession. And in the process set a more doable tone and manageable reality of, in, and for the audit profession's own macro controls environment. If only the audit profession would/could reciprocate by looking at its regulators not only as one of its comfort suppliers, but also by acting as one of its users... the world would now be a better place. It basically boils down to a mutual let-down where there is so much more room and opportunity for a strong positive partnership.

### **Primary focus**

I will focus in particular on the following questions:

- a) How best to get *traction* in the reform process of the auditing profession, or any reform process for that matter – aimed at putting the profession ahead of the curve in preventing a next systemic crises i.e. by creating the necessary conditions for change *by design* and foresight, rather than leaving the world chronically in the vulnerable position of change *by default* only.
- b) How to get the best out of an audit profession, micro and macro, enjoying the privilege that goes with a public, fiduciary function exercised through a for profit business model; its occasional dis-functionality, mortgaging economic fundamentals at the base of orderly functioning financial markets; and,
- c) which accountability instruments are best suited to achieve above goals so as to ensure the profession's optimal added value; for the sake of the auditing profession itself, the auditees, and most importantly the public/investors at large; regulatory/oversight bodies with systemic responsibilities for the orderly functioning of our financial system(s) not exempted.

It is from this intrusive perspective I looked at the Committee's draft report; and will comment on on an exception basis - and on essentials - only; complementing, and hopefully reinforcing the Committees excellent draft proposals so far.

In order to save public hearing time on June 3, I will, somewhat unconventionally for usually sober processes held under aegis of the Treasury Department, illustrate my case in a benignly cartoonist fashion in the format of a Q&A, below.

### **Summary of conclusions**

I see the draft report, overall, as a commendable attempt at incremental change for the better. But lacking a silver bullet readily well within reach - political wills willing - to assure its proposals are not eroded by “agreement by exhaustion”, hence being watered down at each next decision point before turning it into new regulation; and no one being responsible for the consequences. More importantly, I am convinced that audit profession’s functioning, *and that of all actors in the (inter)national financial architecture*, can be considerably enhanced without much new regulation if the Paulson reform package under consideration were to also include a proposal for a paradigm shift in the reporting syntax of *all* actors in the financial architecture, regulators not exempted. Couched, or ‘straightjacketed’ if you wish, in a *results commitment* predicated format.

This would require a move from the present open ended, best effort reporting mode towards a much more disciplined, results based reporting syntax; by *all* actors, at *all* levels; using a reporting framework not unlike the present audit reporting syntax, reasonable assurance predicated. Such *results based* reporting syntax is easily transferable to all macro-actors with a systemic fiduciary remit, be it accounting firms, professional accountants organizations like the AICPA, oversight bodies/gatekeepers such as the PCAOB, SEC, *rating agencies* and, indeed, the FED in the context of the institution’s specific oversight responsibilities for the orderly functioning of the financial markets. Internationally this could/should be extended to and from, top down, the BIS, FSF, Bretton Woods institutions, IFAC, IASB, European Commission etc. In short to all organizations with a remit to assure the orderly functioning of the financial markets.

The present top down regulatory ambiance, without adequate consideration for creating not only a controlled but also an *enabling* environment – the audit profession and its regulators not exempted - does not do justice to sensibly spending tax payers money and hardly enhances the orderly functioning of the markets. Regulators *of* the audit profession are also enablers *for* the profession. Regulators which are unwilling to take their own medicine (governance, transparency, clarity in accounting for how it meets its own remit) in terms of the systemics of their responsibilities, shortchange those they serve. Conversely, an audit profession that is too timid in addressing their regulators also as key enabling agents, charged with creating a viable operating environment, or timely correcting regulators gone awry, will be seen as constantly on the defensive; pushing their industry specific interests through the lobbying circuit and missing in the process an opportunity for creating a platform for constructive exchange of views with public interest and public interest only in mind.

The credit crunch has made visible - and this is a unique opportunity for reemphasizing this - the fact that all gatekeepers are, have been, and will continue to be part of the

problem as well as part of the solution. My comments are focussed primarily on creating the base conditions for a viable operating macro environment for the audit profession and other gatekeepers, so as to minimize the chance of sordid fiduciary history repeating itself over and over again, often for the same erosive reasons.

Before we move to my main theme, I would first like to make a few suggestions on one particular aspect I miss in the transparency proposals of the draft report. Suggestions which in my view will considerably strengthen the Committee's draft recommendations as is.

### **Transparency/disclosure statement(s)**

As I understand it, the proposed registered firms filings are limited to the firms registered with the PCAOB. Obviously this should include a full fledged annual report comparable with public company's requirements.

Given the global nature of firms operating internationally under one name, their concomitant reputational risks and legal exposures/potential spill over effects as a result of possible substandard performance of PCAOB registered firms' foreign partners, I strongly recommend regulators to assume, and to be let it known it assumes as a matter of course, that relevant audit firms operating internationally under one name in different jurisdictions operate under *unified management*, unless stated otherwise.

Firms operating under one name but disclaiming unified management should explain so in their transparency/disclosure statement; and the practical consequences thereof in terms of legal liability and professional (co)responsibilities assumed for the work carried out by their foreign associates; including an explanation why they would operate under one and the same name despite this disclaimer; and whether and how they are managing such self-inflicted expectation gap that goes with their - in fact and in appearance- governance and operating schizophrenia.

Firms operating internationally under unified management should include in their filings, next to their own financial statements and annual report- a no-brainer for a principal agent of transparency-, the combined/consolidated financial statements of the international member firms, in accordance with (public company inspired) provisions set forth for PCAOB registered firms; including an 'in control' comfort statement vouching in systemic results terms for the quality assurances of the firms professional services, prospectively and retrospectively; as well as the integrity of the (combined) financial statements submitted; to be signed by the global firm's senior management as an expression of all partners operating under the global name assumed collective responsibility.

Finally, there are two major issues I have with the business model of the large international firms operating under one name. I.e. issues beyond the usual suspects such as independence, the fact that they still are predominantly cost sharing operations rather

than economic unions, all of which warrant routine attention and explanation in their public filings.

But there are two more:

The first is the fact that the firms do not control the quality of local regulatory provisions on accounting standards. Which is to say audit firms (can) control globally the (audit) production process, but not the local material that makes for the ultimate product- the auditees local financial statements- audit firms associate their name with through their audit report. The firm's policies and procedures in that regard (do we sign off on anything with our global name a local regulator deems fit?) should be clarified in their disclosure/transparency statement. In particular whether the firm concerned has established any minimum standards as regards association with financial statements prepared on the basis of regulatory accounting standards deemed too farfetched or substandard for the firm's professional comfort, hence does not want to associate itself with.

Secondly, there is the elephant in the room, i.e. the political risks of global audit firms being arm-twisted into following the mores of national governments, also when expressing audit opinions. If large mega-organizations in the information industry can be made to tailor their products to narrow national power-politics folklore, why could/would this not happen to audit firms? In particular but not exclusively in countries which often also have major state participations in the companies audited. Or when auditing companies under explicit or implicit state guarantee. History has it that regulators, in particular in times of crises, present company not exempted, can find themselves in charge of collective window dressing if this is perceived in the national/ or 'powers that are' political interest. Or can force audit firms in historic revisionist actions by withdrawing previously issued audit reports, be it for the right or the wrong reasons. This politico-regulatory risk, and the way audit firms deal with this risk, should be explained.

Finally, the Committee may wish to consider explicitly that it has taken note of the renewed ambitions boosting consulting practices of audit firms. That, despite the fact that the situation is much healthier than a few years ago when we did not have a prohibition of consulting services for audit clients, the Committee nevertheless also sees the dangers of this becoming a major firm management distraction. At the expense of its public assurance function. And for the Committee to explicitly flag its view, if it can come to agree on that, that it sees a construct of audit firms *exclusively* focused on audits as a viable option at some time in the future, if circumstances warrant it.

## **THE HEART OF THE MATTER**

Which takes me to my main theme, i.e. the introduction of positive assurance statements as the accountability and transparency baseline for all actors/gatekeepers in the financial architecture, aimed at clarifying the exact comfort level each actor adds to our collective

desire for orderly functioning markets. I would like to mention up front that adoption of my proposal would signify a paradigm shift in the traditional accountability structure of the (inter)national financial architecture as we have known it for many decades; put regulators and rating agencies productively on the spot in an unprecedented way; and would signify a seismic change in a discovery process that will challenge the traditional concepts of financial fragility simply by much more effectively and timely smoking out the unknowns in the financial systems and financial architectural equation; force the extant disjointed macro governance architecture of gatekeepers better out in the open; and quickly lead to the discovery that up till yesterday and to-day no one felt/feels responsible for the present sorry state of financial market affairs: I.e. that there is no ownership at the top assuming responsibility for the whole.

Moreover, next gatekeeper level up, the reality of the present international/multilateral architecture suggests an inevitability of only piecemeal solutions, held together by ‘coordinating mechanisms’ -at best- of national regulators. Leading to a global oversight architecture predicated on a pretty-and-not-so-pretty non-committing organizing principle also known as “the inmates running the asylum”. In a global, interdependent economy with a pretty free flow of funds, this axiomatic/inherent risk should be recognized up front. It can only be minimized by subjecting global gatekeepers such as the FSF, BIS, IMF, to the same results based reporting rigor as proposed above.

In sum, extending my proposal for assurance statements to international agents with a systemic and fiduciary mandate, would substantially contribute to realistically recognizing, hence reducing, the macro risk profile.

## **THE SYSTEMIC ASSURANCE STATEMENT**

I propose a requirement for introducing a very very simple but effective *results based* reporting requirement for all fiduciary macro actors, at all levels of the financial architecture, in their annual reports. A (dis)comfort statement that is predicated on inclusion of an unequivocal bottom line, a positive assurance statement so dearly lacking at present, i.e. ....” *that in the context of our remit there are/ are no systemic issues that might form a material threat to the orderly functioning of the financial markets... ”.*

Any such assertion would represent an accountability and transparency baseline beyond ‘good internal housekeeping’ practices of the certifying agents. But rather focus on their core *external* role/responsibilities as a crucial performance indicator. To be duly - and most usefully- as the case may be - qualified. Or even leading to a well explained, hence very informative disclaimer. Most importantly, such requirement would flush out in the open the unknowns in each fiduciary actor’s systemic equation, for the world to know. It is worth reminding us here that too many unknowns for anyone’s comfort in the macro equation have been the root cause of the present credit crises.

## Q&A

I imagine the Committee might have some penetrating questions on a proposal which on the surface may seem to go beyond the Committee's own marching orders. In order to clarify the issue and facilitate the discussion I will proceed in the form of a **Q&A**, i.e. looking at my proposal from the possible perspective of the Committee (**Q**), allowing for my answers (**A**) to those questions in a colloquial but substantive fashion. In the process saving time and clearing the way for any residual questions the Committee may have on June 3, 2008.

**Q: Before we move to the hot potato you put on this Committee's table, and before deciding whether it belongs here at all, could you first please clarify the 'in control' assurance statement you expect management of audit firms to express?**

*A: The Committee is aware of the transparency/disclosure proposals made by the EU recently through the so-called EU 8<sup>th</sup> Directive, which include quality assurance requirements, but which falls short of explicitly requiring positive assurance with a clear results based syntax as proposed above. I am not aware of any current empirical research on the actual very recent roll out of this EU requirement but anecdotal evidence suggest useful first attempts by firms in complying with this EU requirement, albeit in different formats of assurances, ranging from the descriptive to the more prescriptive, even results based assurance syntax.*

*Which brings me to the suggestion that, first, the Advisory Committee be more explicit up front as regards the transparency requirement of the audit firms; in particular this to be couched in an explicit requirement for a positive assurance statement/bottom line on the firms main public interest remit. Duly qualified where applicable, certifying the firm's senior management's believe "that the firm for all practical and substantive purposes has controls in place that ensure and will ensure meeting reasonable public expectations as regards the firm's effective functioning as a fiduciary agent, in accordance with all applicable regulation"; or words to that effect.*

*Second, in the context of the privilege of audit firms to commercially 'piggyback ride' on a public function through a for profit business model, and in humble return of the favor, firms to share in a transparency report their systemic observations on the financial (macro) systems as operating, based on their day to day wealth of practice and unique vantage points. I.e. on "systemic weaknesses" they discern, if any, "that might present a material threat to the orderly functioning of the financial markets." I am glad to note a increase awareness and willingness by firms and professional organizations to move into that direction.*

*I do not think such early warning public service is too much asked, in particular in the light of the present credit crises, and the with hindsight predictability of it all. I do not feel this crises is due to a collective failure of the audit profession, but I do feel the profession's silence over the emerging systemic risks is a very regretful missed*

*opportunity in regaining public confidence that had been so dented as a result of previous (Enron/Dotcom) audit credibility crises.*

**Q: Are you suggesting the profession was aware of a credit crunch in the making?**

*A: December 2004 I was invited to speak for the Annual Conference of the Dutch Institute of Registered Accountants (NIVRA) . Simply by on putting my ear to the ground in my professional network, dialoging with financial markets specialists and risk managers, and with a pedestrian awareness of the existence of perverse business incentive systems in the back of my mind, I had little difficulty publicly predicting at the time the inevitability of a crises -presently unfolding- to come; and its base reasons. Simply by adding up all the unknowns in the systemic equation, ranging from a profession too much out of touch with the arcane language of finance, the feeble operating assumption one can account for financial products that not only buyers but also sellers no longer understood, up to and including the alarming re-emergence of off balance sheet accounting practices. When combined with unaccountable oversight bodies and no ownership or assurances whether and how it all ads up, it was not particular rocket science to conclude we were heading for disaster. Mix these weaknesses with perverse incentive systems monetizing thin air, preferably with up front payments for services rendered, and short of claw-back provisions when stretched promises do not pan out, with mixed attribute accounting in a world lacking double entry bookkeeping for income recognition at the macro level, all toxic ingredients for a major accident waiting to happen building up to its present implosive effect. We are talking late 2004. One did not need the present criticism of overly generous monetary and interest policies to see a crises coming. I identified at the time the US housing market as the likely trigger, and the overabundance of black holes in our financial system, macro and micro, as the most likely root cause. (In 2005 this speech was transformed into a (co-authored) article, “Survival kit for accountants and auditors in a turbo derivative environment” published by same NIVRA, basically writing the script for a scenario as we have seen unfold over the last year).*

*Regretfully, the profession was and stayed in denial. It can do much better than that. Hence my prodding for getting the profession’s useful systemic observations from its unique vantage point, bottom up, better structured, out in the open; preferably in an orderly fashion. The Committee’s own proposals for the profession to set up a platform for exchange of experiences will help, but it should not be limited to fraud and error. There is a lot of potential for the profession to play its role as an indispensable economic fundamental in all it does. But also in what it sees!*

*In sum, no I look at the profession’s passivity and myopic “not my department” attitude as an unfortunate missed opportunity; not as collective negligence. That award goes for this particular credit crunch occasion to our regulators annex rating agencies.*

**Q: The Committee understands you propose to use the syntax of audit reporting, and graft it onto audit firms organizational/operational assurance formats; and even use it for systemic assurances by financial market oversight bodies at the macro level. Could you elaborate?**

*The objective of my now decennium long crusade to introduce macro-assurance statements by all gatekeepers (there is a 2000 working paper from my hand on the subject for discussion in the context of what is now called “Forum of Firms”, under IFAC auspices) is to prevent we are entailing (again) on a reform movement that does not meet the litmus test of efficiency, effectiveness and sustainability. A reform process with traction requires accountability instruments, micro and macro that smoke out by their very design present and future unknowns. Short of such results based baseline one runs the risk planting the seeds for the next crises, creating through perpetual reform processes only a fig leaf for predominantly process driven remedial actions planted on an endless treadmill direction progress; but never really getting there; even if we were to assume the rest of the world will stand still from to-day onwards. Because once the new rules of any reform game have been established, in particular when the new rules are only informational/descriptive, with no bottom line, no results commitment, the game of the rules will start. A results based assurance statement - on systemics only, can we put the bar any lower? – introduces accountability and transparency with teeth; even when the processes that underpin it all do not suffice, or we have changing or unforeseen circumstances upsetting the original reform design assumptions. It will force our fiduciary actors when signing to ask themselves the base question:” Yes, we ticked all the boxes, but is it right? And is it all?”*

*My sense is, without the introduction of a macro reporting syntax with teeth and commitment, history will have it that also this Advisory Committee will be seen as usefully wallpapering the bedroom when the roof is still leaking. Its commendable proposals will degenerate over time into very commendable tinkering in the margin. Hence my strong call to include in the Committee’s report a need for new accountability constructs beyond the micro (auditor), mezzanine (audit firms), but also covering macro oversight bodies, rating agencies not excluded, on the systemics of their remit; implying also a call for oversight bodies to take their own medicine. Remember, ironically, corporate management and auditors are at this moment the only micro actors called upon to deliver results based assurance statements; all other gatekeepers, rating agencies included, going for the exits as soon as soon as the suggestion is put on the table. One has to ask oneself why that is. The few reasons I see are very simple: 1) The instrument locks one into a pretty tangible assurance/commitment; 2) It raises questions one might not want to hear/know the answer to; 3) Signatures follows signatories for the rest of their life; 4) Life was good without it.*

*Paradoxically, oversight bodies with open-ended reporting frameworks are mostly grossly under-resourced for the task at hand; and grossly overpaid for the responsibilities they are willing to take. Results based assurance statements will change all that, force us to look at the realities of that implicit expectation gap; and be conducive*

*to a dramatic fresh look at resource allocation vs political risk appetite; plus lead to a much more considered risk management. It will also give us the benefit of being able taking our head out of the sand; which can be quite a relief.*

**Q: All major financial calamities annex audit failures we have seen so far have been preceded by clean audit opinions. Why would it be different if we were to take this assurance instrument to the next macro/systemic regulatory level?**

*A: Good question. But one that begs the question what would happen if we were to do away with the audit function full stop. I have on various occasions in the past thrown out a less revolutionary teaser suggesting that we should ban clean audit opinions as an audit reporting instrument for at least ten years to come. Just to wean the audit profession of its addiction to clean opinions. And to make it recognize a public interest in having the **right** opinion, rather than a **clean** opinion per se. If the profession would better marshal the professional courage it takes to use its whole panoply of audit opinions, in particular disclaimers when disclaimers are due, the world would be a better place. Having said that I have the clear impression that more recently the profession is constructively trying to pull its weight more robustly in the privacy of the backroom negotiations that go with audit closing meetings. Remember, we only see the waves caused by dysfunctional audits, not the invisible undercurrents that steer audit clients into changing their minds; to change their financial reporting. This invisible audit hand never shows up on the public screen. And cannot be shared because of client confidentiality.*

*Ironically, the audit reporting record in the public sector is considerably better than in the private sector, both the US federal government and the EU Commission having been showered over the last decade and a half with heavily qualified audit opinions on their accounts; and adverse opinions on controls. Very informative. Also, Deloitte's second year in a row heavily qualified opinion on the FED's own accounts offers hope it can be done and is being done, professional spine and effective audit independence willing.*

*But the temptation at the systemic level, i.e. the political pressures oversight bodies might feel from its political peers not to be too alarmist, is real; yet an inevitable part of professional life. It would be naïve and disappointing if that were the only reason for not even trying. Reforms by their very nature are discovery processes. Discovery processes by their very nature entail risk taking. The only reason I can think of for not even trying is that we might not want to hear what oversight bodies have to say; think of systemic risks with the potential of turning into self-fulfilling prophecies. But we have to grow up.*

**Q: So, isn't this cloud-cuckoo-land? What is the price, if any, of not pursuing it?**

*A: We will lack a baseline for all things gatekeepers do and are expected to do. Yet are never asked to express meeting their remit as a whole in a bottom line we can do something with. We will be condemned to sordid reform history repeating itself; a red tape fest of wack'a mole; with never ending open-endedness in accountability; leaving*

*the door open for premature politicking where professional deliberation should be the key note; and allow vested interest to dominate the landscape. We will miss a macro management tool for effective prioritization in the allocation of fiduciary resources. We will give priority to process and data-expansion - to the point of suffocation- keeping the audit profession, the rating agencies, and all our other macro control mechanisms in cloud-cuckoo-land. I am not trying to get you into cloud-cuckoo-land; because that's where we presently are.*

*Remember that old nursery rhyme about the old lady who ate a spider... and then a mouse to catch the spider... and then a cat...etc. If the Committee still does not see the advantages of creating clarity at all oversight levels, I might suggest it should join me visiting the old lady's grave, prior to taking a decision. It is conveniently close to home.*

**Q: Can you give us an example of any such macro assurance statements in practice?**

*A: The UK's Financial Reporting Council's (FRC) "Plan&Budget 2008/2009 proposal comes closest to the expression of positive assurance. Still soft in its overall assurances it is heavily qualified with a number of useful observations and reservations which make clear what and where the FRC sees systemic problems. It is far from perfect yet. It is based on very useful stakeholders input, hence pushes the envelope in forcing all relevant parties to think through where its priorities should be and why; and forces through its consultation process common ownership for the (completeness of) risks identified among its stakeholders. It is for my taste still too UK centric, looks at the credit crises as something that happens without exploring in depth how it could have been avoided, and could usefully include more what I would like to call "axiomatic qualifications" i.e. reminders to the readers that it operates in a global setting which means having limited controls over all relevant variables; and specifying such 'constants'. Bifurcating its uncertainties into manageable and non-manageable variables would help clarify the responsibilities an agency can reasonably assume in meeting its objectives. With such axiomatic qualifications it would clearly ring-fence the doable; leaving the user of its reports with an inventory of exogenous risks in search of an owner.*

*But in terms of format, the FRC's model is a commendable start, worthy the Committee's attention.*

**Q: What about macro –assurance statements in the public sector? Are there useful lessons to be drawn?**

*A: The public sector is as receptive to the idea of macro-assurance statements – reacts to it as poison ivy in a three star restaurant- as the private sector. It has a young history which may explain the stonewalling of this effective macro-controls instrument. A couple of years into my job at the World Bank as its Controller I realized - belatedly perhaps- that there was no way of assuring that lending money would be spend for purposes intended lest one got the active attention/cooperation and signature to that effect of the Ministers of Finance/CFO's of the national governments of beneficiary countries. And I commissioned a project for a country-disclosure statement, including a bottom line*

*assertion by the highest authorities that controls were in place assuring that the money would be spend for purposes intended. This would be a paradigm shift, an add on to the extant very demanding project management controls regulation; in addition to also providing a fiduciary umbrella for direct budget support ('structural') lending. It took a while to get Bank management buy in for this controls tool (do we really want to hear the answer?) but it was finally informally discussed with the Bank's Board where it quietly died in conference; some countries protesting that any such requirement would be an infringement of national sovereignty (sic). Same instrument was revived when I joined the European Commission in 2001; and came to realize that, with EU member states spending 80% of the EU budget under joint management with the Commission, top down red tape controls from Brussels could never do the trick in assuring EU funds were being used for purposes intended. And the Commission would never get out of its embarrassing position of member states misspending funds and the Commission being blamed for it. For that one needs ownership at top level in each EU member state, hence I proposed a requirement for Ministers of Finance formalizing the understanding and legal provision that member states have prime responsibility for EU money spend. In the meantime, the EU Parliament, sick and tired of the Commissions perceived sloppy good housekeeping practices, discovered this macro-controls accountability loophole and has in various Parliamentary resolutions insisted on very penetrating and effective country macro-assurance statements, requiring EU member countries' Ministers of Finance to sign off 'in control' statements assuring that national controls are in place that **will** ensure that EU money will be used for purposes intended (note its prospective features!); to be followed by a retrospective assurance statement once the money has been spend.*

*There has been vehement opposition against the idea by a number of EU Ministers of Finance, the spending agents, who ironically also have oversight responsibility through the EU Council for the good housekeeping practices of the European Commission. But at the same time they are the principle agents under whose responsibility these funds are being spend. Needless to say, there is little appetite to commit oneself in writing, by way of an assurance statement that will follow signatories after leaving office. But there is also a promising development, four EU member states ( the UK, the Netherlands, Denmark and Sweden) having agreed, and some others expressing some interest, in introducing this admittedly vital macro controls tool. And in the process discovered how little they actually knew how their own controls systems, or lack of it, over EU money, guaranteed by each member state for proper use, worked; a very salutary discovery process leading also to a self cleansing exercise no red tape administrative requirements from Brussels could ever achieve.*

*The lessons we can draw from this all is that macro assurance statements initially will upset macro actors who will do whatever they can do to avoid it. Once rolled out, signatories to such statements will acknowledge the beneficial effect the statements had in bringing their own house in order and in discovering too many dangerous unknowns.*

*So to make a long story short, we do see the first macro-assurance statements emerge in the EU public sector, but not without some painful birth-pangs and with a lot of resistance by designated signatories who have gotten away with murder for too long,*

*especially on the systemics of their remit. But it also protects macro assurance pioneer countries from future undue risks having to pay EU public funds back, with or without heavy penalties; or at the political price of a cynic European electorate reading only about the fraud waste and error, and too little about the progress made.*

*This Committee might take note of what it can expect once it decides to further explore this macro-controls instrument.*

**Q: How would you kick start this; and what would be the endgame?**

*A: I would follow a Dutch Housewife's first article of believe: "Sweep the stairs from the top down". Internationally I would require the Financial Stability Forum, set up with such high hopes in de late 90's but asleep at the switch from then on till the sub prime shoe dropped, to go through a dry run of what their annual reports would look like; what difference it would make from cherry-picking areas of concern to actually have an overall results expectation as a base line. This could yield a wealth of insights to be shared with its stakeholders, such as the US gatekeepers, who can then take over the baton and go through the same exercise. Although nothing should stop Treasury and the FED (and the rating agencies!) not to wait but 'do it my way', right away.*

*The endgame would be a pro-forma report mimicking reality as much as possible. It will probably show a host of uncertainties now better known to us by default, such as dysfunctionalities in the oversight mechanism, escapism made visible (rating agencies), our intrinsic lack of knowledge about the systemic effect of financial products which are not properly understood by market parties themselves; and/or by their accountant; the fact accounting rules cannot solve black holes in the markets themselves; lack of assurances in the gatekeeper hierarchy bottom up as a basis for overall macro assurance.*

**Q: But what do you really expect us to say on this score to the Secretary of the Treasury? "Mr. Secretary, based on our terms of reference it seems really none of our business but we have this tedious Dutchman here, legal immigrant, who has been peddling macro-assurance statements for the last ten years of his life both in the public and private sector. Got the run-around most of the time by most of the world that counts, except that the Dutch Minister of Finance has recently taken the lead in Europe and decided to pull his finger out of the dike, come hell or high water; with his/your colleagues in Britain, Denmark and Sweden following; all other EU allies sitting on the fence or having taken cover.**

**Mr. Secretary, this bodes some good news and some bad news for you. The good news is, if you were to follow this Dutchman's proposal for introducing results based assurance statements at regulatory level that you will be blessed on the receiving end with assurances from the SEC, PCAOB and other fiduciary agencies under your command that they see no systemic weaknesses that might materially upset the orderly functioning of the financial markets- remember at this moment**

**they have convincingly proven dis-functional - except for the ones they choose to flag. That is more orderly process comfort any Secretary of the Treasury ever had on the public policy financial markets front. The bad news is, if one were to follow the logic of the proposal, that you as the Mother of all Gatekeepers, along with Chairman Bernanke, your countervailing FED power a few blocks from here, would have to countersign to the overall effect that you believe it.”**

**Where would you think Secretary Paulson will tell us to go?**

*A: I cannot really speak at this juncture on behalf of the Secretary, but I could imagine he'd say: “Thank you very much for telling me. If such systemic assurance statement were to be put on my table I'll go to the President to ask for a transfer to Homeland Security; they know much better how to deal with these type of weapons of mass self-destruction”.*

**Q: We have passed your proposal for systemic assurance statements on to Homeland Security for vetting and possible application to Homeland Security itself in managing its risks and that of its dozens of agencies; and as a possible tool in establishing Homeland Security's own effectiveness. The feedback we got was that “taunting its agencies with reporting mechanisms that would reveal the disjointed nature of the operations, the blind spots in discovery processes, their identified weaknesses as well as their particular strengths, would be a serious threat to national security. Additionally it would put the present inter-agency budget/resource allocations in a suspicious light; demonstrate major loopholes in coverage and priority setting and reveal its ‘best effort’ mode as apposed to a results systemic orientation with bite”.**

**Needless to say, that would also apply to orderly functioning assertions for the financial markets; an assurance statement as proposed would inconveniently upset the appearance of ‘in control’ that went for decades, very conveniently with the present open-ended reporting syntax of our oversight bodies; an emperors cloth situation that has been such a blessing in the financial markets in the good times.**

**You have anything to say in your defense?**

*A: Guilty as charged*

Mr Chairmen, members of the Committee, I apologize not having written you a shorter comment.

In reading back my commentary I was reminded of one of the best reality check lesson I ever had from one of my senior partners, when I was advocating following Andersen's example, in the late 80's, of preparing and publishing the firm's financial statements; a

professional example he clearly had no appetite for following: “Jules, one should never be so open-minded that one’s brains pop out”.

I imagine some Committee members being sympathetic to my partners sentiment. i.e. that the law of diminishing returns also applies to transparency, in particular on sensitive matters that, when disclosed, get their own life, possibly turning into self-fulfilling prophecies; the cure being worse than the disease, and litigation looming above the horizon. Yet any decision not going for this low hanging fruit in macro accountability’s orchard, should be based on proper public debate about its costs/benefits, the costs of not doing it being financial crises history assuredly repeating itself.

It has been a privilege having this window of opportunity; and commenting on the Committee’s good work.

Sincerely

Jules W Muis